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Checklists and illustrative financial statements for investment companies : a financial accounting and reporting practice aid, December 1994 edition

American Institute of Certified Public Accountants. Technical Information Division

Michael A. Tursi

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AICPA

**DECEMBER 1994
EDITION**

Checklists and Illustrative Financial Statements for Investment Companies

*A Financial Accounting and
Reporting Practice Aid*

AMERICAN

INSTITUTE OF

CERTIFIED

PUBLIC

ACCOUNTANTS

CHECKLISTS AND ILLUSTRATIVE FINANCIAL STATEMENTS IN THE SERIES

Checklists and Illustrative Financial Statements for Corporations

Checklist Supplements and Illustrative Financial Statements

Checklist Supplement and Illustrative Financial Statements for Construction Contractors

Checklist Supplement and Illustrative Financial Statements for Investment Companies

Checklist Supplement and Illustrative Financial Statements for Real Estate Ventures

Checklist of Emerging Issues Task Force Consensuses

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Checklists and Illustrative Financial Statements for Finance Companies

Checklists and Illustrative Financial Statements for Health Care Providers

Checklists and Illustrative Financial Statements for Life Insurance Companies

Checklists and Illustrative Financial Statements for Not-for-Profit Organizations

Checklists and Illustrative Financial Statements for Property and Liability Insurance Companies

Checklists and Illustrative Financial Statements for Savings Institutions

Checklists and Illustrative Financial Statements for State and Local Governmental Units

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Checklists and Illustrative Financial Statements for Investment Companies

*A Financial Accounting and
Reporting Practice Aid*

*Edited by
Michael A. Tursi, CPA
Technical Manager, Technical Information Division*

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FSP Section 16,000

CHECKLIST AND ILLUSTRATIVE FINANCIAL STATEMENTS FOR INVESTMENT COMPANIES

.01 The checklist and illustrative financial statements included in this section have been developed by the staff of the Technical Information Division of the AICPA as nonauthoritative technical practice aids. Readers should be aware of the following:

- The checklist and illustrative financial statements are “tools” and in no way represent official positions or pronouncements of the AICPA.
- The checklist and illustrative financial statements are to be used in conjunction with the “Checklists and Illustrative Financial Statements for Corporations” (FSP sections 2000—2600) and have been updated to include relevant accounting pronouncements through FASB Statement of Financial Accounting Standards No. 117, FASB Interpretation No. 40, FASB Technical Bulletin No. 90-1, AICPA Statement of Position No. 93-5, AICPA Practice Bulletin No. 10, and AICPA Audit and Accounting Guide, *Audits of Investment Companies* (with conforming changes as of May 1, 1994). The checklist and illustrative financial statements should be modified, as appropriate, for subsequent pronouncements. In determining the applicability of a pronouncement, its effective date should also be considered.
- The checklist and illustrative financial statements should be used by, or under the supervision of, persons having adequate technical training and proficiency in the application of generally accepted accounting principles, generally accepted auditing standards, and statements on standards for accounting and review services.
- The checklist and illustrative financial statements do not represent minimum requirements and do not purport to be all-inclusive. The referenced standards should be reviewed if clarification is needed to determine whether the disclosure indicated is required or suggested, and to what extent each disclosure is relevant to the statements being presented.

.02 Users of the checklist and illustrative financial statements are urged to refer directly to applicable authoritative pronouncements when appropriate. If you have further questions, call the AICPA Technical Hotline.

Note: This publication was extracted from sections 16,000 through 16,300 of the *AICPA Financial Statement Preparation Manual* (FSP).

FSP Section 16,100

Introduction

.01 Investment companies generally are companies that pool shareholders' funds and invest the proceeds for the benefits of shareholders under the supervision of professional investment management. The investments are generally in securities that are intended to meet the investment objectives of the entity. The entity distributes the net income and realized net gains to its shareholders.

.02 The industry is subject to extensive governmental regulation by the Securities and Exchange Commission ("SEC"). The industry also is the subject of special tax treatment. The investment company industry usually is categorized by the type of security or the investment objective.

.03 There are many types of investment companies: management investment companies, unit investment trusts, collective trust funds, investment partnerships, certain separate accounts of life insurance companies, and offshore funds. Management investment companies are further divided into many sub-classifications, the most predominant of which is open-end funds, also called mutual funds. There are also closed-end funds and Small Business Investment Companies.

.04 The checklist has been designed primarily for auditors of mutual funds and closed-end investment companies that register with the SEC under the Investment Company Act of 1940. However, the checklist would generally apply to all types of investment companies.

.05 Investment companies covered by the checklist are required to report their investment assets at value and have the following attributes (not applicable to real estate investment trusts):

- a. *Investment activity.* The primary activity is the investment in securities of nonaffiliates or entities not under common management for current income, appreciation, or both.
- b. *Unit ownership.* Ownership in the investment company is evidenced by units of investments, such as shares of stock or partnership interests to which proportionate shares of net assets can be attributed.
- c. *Pooling-of-funds.* The funds of the owners are pooled to avail owners of professional investment management.
- d. *Reporting entity.* The investment company is the primary reporting entity.

.06 The major accounting and auditing literature and applicable regulations for investment companies are as follows:

- a. AICPA Audit and Accounting Guide, *Audits of Investment Companies*.
 - b. SOP 89-2, *Reports on Audited Financial Statements of Investment Companies*.
 - c. SOP 93-1, *Financial Accounting and Reporting for High-Yield Debt Securities by Investment Companies*.
 - d. SOP 93-2, *Determination, Disclosure, and Financial Statement Presentation of Income, Capital Gain, and Return of Capital Distributions by Investment Companies*.
 - e. SOP 93-4, *Foreign Currency Accounting and Financial Statement Presentation for Investment Companies*.
 - f. Article 6 of Regulation S-X of the Securities and Exchange Commission.
 - g. The Securities Act of 1933.
 - h. Investment Company Act of 1940.
-

FSP Section 16,200

Financial Statements and Notes Checklist

.01 This checklist has been developed by the staff of the Technical Information Division of the AICPA as a nonauthoritative practice aid and is to be used in conjunction with the "Checklists and Illustrative Financial Statements for Corporations" (FSP sections 2000—2600).

.02 The form and content of the investment companies' financial statements required in SEC filings are governed by Regulation S-X, Article 6 that deals specifically with investment companies (SBIC's are covered in Article 5).

.03 Explanation of References:

AAG-INV = AICPA Audit and Accounting Guide, *Audits of Investment Companies* (with conforming changes as of May 1, 1994)

Reg. S-K = SEC Regulation S-K

Reg. S-X = SEC Regulation S-X

SOP = AICPA Statement of Position

.04 Checklist Questionnaire

Yes No N/A

General

A. Financial Statements Presented

1. Are the following financial statements presented:

a. Statement of assets and liabilities or a statement of net assets as of the close of the latest period?

(1) Does it include a detailed list of investment in securities?

(2) Covered call options written?

(3) Securities sold short?

(4) Other investments?

b. Statement of operations for the latest period?

c. Statement of changes in net assets for the latest two years?

d. Statement of cash flows for the latest period if the conditions of SFAS 102 are not met?

e. Selected per-share data and ratios for the latest five years or from the date of inception?

[AAG-INV, par. 5.01]

B. Reporting Financial Position

1. If a statement of net assets is permitted, is at least 95% of total assets invested in securities of nonaffiliated issuers?

[AAG-INV, par. 5.05]

2. If a statement of assets and liabilities is used, does it list assets and liabilities in sufficient detail and an amount for net assets?

[AAG-INV, par. 5.06 (Reg. S-X, 6.04 (7))]

3. Does the statement of net assets present a detailed list of portfolio securities and a net amount for all other assets and liabilities?

[AAG-INV, par. 5.07]

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
Statement of Assets and Liabilities			
A. Assets			
1. Investments			
a. Are investments in securities the first item in the asset section? [AAG-INV, par. 5.09]	_____	_____	_____
b. Are securities reported at value with acquisition cost shown parenthetically by major classification of securities? [AAG-INV, par. 5.10]	_____	_____	_____
c. Are investments in foreign securities reported at value by converting their foreign currency value into U.S. dollars using current exchange rates? [AAG-INV, par. 5.10]	_____	_____	_____
d. If a statement of assets and liabilities is used, are individual securities held by the fund listed in the statement or in an accompanying list by major classifications of the investments in the portfolio? [AAG-INV, par. 5.10]	_____	_____	_____
e. Are significant investments in foreign securities disclosed and presented separately in a representative grouping? [AAG-INV, par. 5.10]	_____	_____	_____
f. Are securities arranged in the most meaningful manner within each classification by industry or group with disclosure of the percentage of assets in each group? [AAG-INV, par. 5.10]	_____	_____	_____
g. Does the portfolio listing indicate the number of shares or principal amount and value of each security issue? [AAG-INV, par. 5.11]	_____	_____	_____
h. If short-term investments are summarized by issuers (money market mutual funds should present in detail) is disclosure made of their ranges of interest rates and maturity dates? [AAG-INV, par. 5.11]	_____	_____	_____
i. Is specific disclosure made of investments in restricted securities nonincome-producing, affiliated companies and securities subject to call options? [AAG-INV, par. 5.11]	_____	_____	_____
j. Is the entity's practice of either including or excluding that portion of realized and unrealized gains and losses on investments that result from foreign currency changes with or from other foreign currency gains and losses disclosed? [SOP 93-4, par. 35]	_____	_____	_____
k. Are the following disclosed with respect to investments in foreign securities:			
(1) Liquidity?	_____	_____	_____
(2) Size?	_____	_____	_____
(3) Valuation? [SOP 93-4, par. 37]	_____	_____	_____
2. Cash			
a. Is cash on hand and demand deposits included under the general caption "Cash"?	_____	_____	_____
b. Are foreign currencies, if material, disclosed separately?	_____	_____	_____
c. Are time deposits and other funds subject to withdrawal or usage restrictions presented separately with disclosure of applicable interest rates and maturity dates? [AAG-INV, par. 5.12]	_____	_____	_____
3. Receivables			

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
a. Are the following receivables listed separately:			
(1) Dividends and interest?	_____	_____	_____
(2) Investment securities sold?	_____	_____	_____
(3) Capital stock sold?	_____	_____	_____
(4) Other accounts receivable, such as receivables from related parties or expense reimbursements from affiliates? [AAG-INV, par. 5.13]	_____	_____	_____
(5) Notes receivable, if the aggregate amount exceeds 10% of the aggregate amount of the receivables? [Reg. S-X, 6.04—.06]	_____	_____	_____
4. Deposits for securities sold short and open-operation contracts			
a. Are amounts held by others in connection with short sales and open-option contracts presented separately?	_____	_____	_____
b. Is an allowance for uncollectible interest shown as a deduction from the related receivable? [AAG-INV, par. 2.107]	_____	_____	_____
5. Other Assets			
a. Do other assets include items, such as deferred organization expense, prepaid taxes, and furniture and fixtures, with only significant items separately disclosed? [AAG-INV, par. 5.14]	_____	_____	_____
6. Total Assets			
a. Is the amount of total assets shown on the statement? [Reg. S-X, 6.04—.09]	_____	_____	_____
B. Liabilities			
1. Accounts Payable			
a. Are accounts payable listed separately for investment securities purchased, for capital stock reacquired, and for dividends or other distributions on capital shares? [AAG-INV, par. 5.16; Reg. S-X, 6.04—.10]	_____	_____	_____
b. Are call or put options written, future contracts sold, and securities sold short disclosed?	_____	_____	_____
(1) Are call options written and securities sold short at the end of the period presented separately?	_____	_____	_____
(2) Does the information for covered call options include the number of shares subject to call for each option written, the value of each option, the strike price, and exercise date?	_____	_____	_____
(3) Does the information presented for securities sold short, other options written, and futures contracts sold include date about quantities, values, and proceeds? [AAG-INV, par. 5.17]	_____	_____	_____
2. Taxes			
a. Does the entity meet the provisions of subchapter M of the Internal Revenue Code? [AAG-INV, par. 1.37]	_____	_____	_____
b. Are federal income tax liability and related deemed distributions recorded for any undistributed realized taxable long-term gains for which election has been made to pay the federal income tax for their shareholders? [AAG-INV, par. 1.37]	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
c. Are state, local, and foreign taxes (both current and deferred) reported on the accrual basis and recorded on unrealized appreciation or depreciation of investments? [AAG-INV, par. 1.38]	_____	_____	_____
d. If the entity does not qualify under Subchapter M of the Internal Revenue Code, is a provision for deferred federal taxes on unrealized appreciation or depreciation recorded in addition to federal income taxes on net investment income and realized gains or losses? [AAG-INV, par. 1.39]	_____	_____	_____
e. Are the amounts and expiration dates of capital loss carryforwards for tax purposes disclosed? [AAG-INV, par. 4.35]	_____	_____	_____
3. Accrued Liabilities			
a. Are accrued liabilities disclosed, including taxes, management fees, interest, compensation expenses, and other expenses, with separate disclosure of related-party amounts? [AAG-INV, par. 5.18]	_____	_____	_____
b. Are notes payable to banks and to others and other funded debt reported separately with separate disclosure of related-party amounts? [AAG-INV, par. 5.19]	_____	_____	_____
c. Is disclosure made regarding unused lines of credit for short-term financing and unused commitments for long-term financing arrangements?	_____	_____	_____
d. Do other liabilities include amounts payable to affiliates for collateral on return of securities loaned, for deferred income, and for dividends? [AAG-INV, par. 5.20]	_____	_____	_____
e. Are reverse repurchase agreements presented?	_____	_____	_____
4. Total Liabilities			
a. Is the amount of total liabilities shown on the statement? [Reg. S-X, 6.04—.14]	_____	_____	_____
b. Are commitments and contingent liabilities disclosed? [Reg. S-X, 6.04—.15]	_____	_____	_____
5. Net Assets			
a. Is the amount of net assets shown in the statement? [Reg. S-X, 6.04—.19]	_____	_____	_____
b. If not required to be disclosed separately in the statement of assets and liabilities, does the statement or notes disclose the following:			
(1) The title of each class of capital shares or other capital units, the number authorized, and the number outstanding?	_____	_____	_____
(2) Paid-in capital, which includes the net proceeds received on sale of capital shares less the cost of reacquired shares, adjusted for amounts apportioned to the equalization accounts, if that accounting procedure is followed?	_____	_____	_____
(3) Undistributed investment income, which includes cumulative investment income or loss, equalization apportionments, if necessary, less dividends from net investment income (amounts at the end of the periods presented are normally disclosed in the statement of changes in net assets)?	_____	_____	_____
(4) Accumulated net realized gains and losses from security transactions, net of actual or deemed dividends to shareholders?	_____	_____	_____
(5) Unrealized appreciation or depreciation of investments, forward contracts, option contracts, written short positions in securities, and assets and liabilities demonstrated in foreign currency? [AAG-INV, par. 5.21]	_____	_____	_____

- c. Is net asset value per-share disclosed?
[AAG-INV, par. 5.23]

Yes No N/A

Statement of Operations

A. Income

1. Is income from dividends, interest on securities, and other income that exceeds 5% of the total income stated separately?
[Reg. S-X, 6.07]
2. Is disclosure made that dividend income is recorded on the ex-dividend date?
[AAG-INV, par. 5.25]
3. Are dividends from affiliates and controlled companies reported and disclosed separately?
[AAG-INV, par. 5.25]
4. If noncash dividend is included in income, are the amount and bases of recognition and measurement disclosed?
[Reg. S-X, 6.07.1]
5. Is disclosure made that interest income is accrued on all debt securities on a daily basis?
[AAG-INV, par. 5.26]
6. Is interest from affiliates and controlled companies reported and disclosed separately?
[AAG-INV, par. 5.26]
7. Is the method of amortizing bond discounts and premiums disclosed?
[AAG-INV, par. 2.114]
8. Is the interest received on bonds that were in default or that were delinquent in the payment of interest when acquired accounted for as:
 - a. Interest income for the amount earned from the date of acquisition through the current period?
 - b. A reduction in the cost of the investment in terms of the amount relative to arrearages at the date of the acquisition?
[AAG-INV, pars. 2.108 and 5.26]
9. Is income from securities loaned and from miscellaneous sources included as other income?
[AAG-INV, par. 5.27]
10. Is a reserve against income established for payment-in-kind (PIK) bonds to the extent that interest income to be received in the form of baby bonds is not expected to be realized?
[SOP 93-1, par. 34]
11. Is a reserve against income established for step bonds to the extent that interest income is not expected to be realized?
[SOP 93-1, par. 35]

B. Expenses

1. Are the following expenses reported separately:
 - a. Investment advisory (management) fees (or compensation)?
 - b. Shareholder service costs, including fees and expenses for the transfer agent and dividend disbursing agent?
 - c. Distribution expenses?
 - d. Custodian fees?
 - e. Reports to shareholders?
 - f. Federal income taxes?
 - g. Other taxes?
 - h. Interest and amortization of bond discount?

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
i. Dividends on securities sold short?	_____	_____	_____
j. Professional fees?	_____	_____	_____
k. Director's fees?	_____	_____	_____
l. Registration fees and expenses? [AAG-INV, par. 5.28]	_____	_____	_____
2. Are reductions or reimbursements of management or service fees shown as a reduction of total expenses? [Reg. S-X, 6.07-2]	_____	_____	_____
3. Based on SEC requirements, are expenses that represent 5% or more of total expenses disclosed? [AAG-INV, par. 5.28]	_____	_____	_____
4. If expenses are paid other than in cash, are the details disclosed? [Reg. S-X, 6.07.2d]	_____	_____	_____
5. Are amounts paid to affiliates or related parties disclosed in accordance with FASB 57 and are the following disclosed:			
a. The amount of brokerage commissions paid to affiliated brokerage-dealers in connection with purchases and sales of investment securities? [Reg. S-X, 6.07-2e]	_____	_____	_____
b. The aggregate remuneration to officers and directors for regular compensation and to each director for special compensation?	_____	_____	_____
c. Information concerning management and service fees, the rate of the fee, and the base and method of computation? [Reg. S-X, 6.07-2c]	_____	_____	_____
d. Description of any fee reductions or reimbursements representing expense limitation agreements or commitments? [Reg. S-X, 6.07-2c]	_____	_____	_____
e. If no management or service fees are incurred, the reasons therefore? [Reg. S-X, 6.07-2c]	_____	_____	_____
f. Payments pursuant to a 12b-1 distribution plan? [AAG-INV, par. 5.29]	_____	_____	_____
g. The amount of sales charges deducted from the proceeds of sale of capital shares that were retained by any affiliated underwriter or other affiliated broker-dealer? [Reg. S-X, 6.07-2(e)]	_____	_____	_____
6. Is the company's status as "regulated investment company" (as defined in the Internal Revenue Code) disclosed, including a description of the principal assumptions on which the company relied in making or not making provisions for income taxes? [Reg. S-X, 6.032]	_____	_____	_____
7. Is the excess of investment income over total expenses shown as investment income-net? [AAG-INV, par. 5.30]	_____	_____	_____
C. Realized Gains or Losses on Investments			
1. Are significant net realized gains or losses from security transactions, short sale transactions, covered call option transactions, and investments other than securities stated separately? [Reg. S-X, 6.07]	_____	_____	_____
2. Are net realized gains or losses reported net of brokerage commissions? [AAG-INV, par. 5.31]	_____	_____	_____
3. Are income tax provisions charged against realized gains disclosed separately? [AAG-INV, par. 5.31]	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
4. Are distributions of realized gains by other investment companies disclosed separately? [Reg. S-X, 6.07]	_____	_____	_____
5. Are gains arising from in-kind redemptions disclosed? [AAG-INV, par. 5.31]	_____	_____	_____
6. Is disclosure made of the proceeds from sales of securities and the cost of securities purchased separately for U.S. government obligations and other than U.S. government securities? [AAG-INV, par. 5.32]	_____	_____	_____
7. For a money market fund, is consideration given to combining net realized gains or losses (usually insignificant) with interest income? [AAG-INV, par. 5.32]	_____	_____	_____
8. Is the primary reason for any significant difference between total GAAP-basis net income and realized capital gains and actual distributions disclosed in the notes to the financial statements? [SOP 93-2, par. 13c]	_____	_____	_____
D. Changes in Unrealized Appreciation or Depreciation of Investments			
1. Are changes in unrealized appreciation or depreciation of investments together with related disclosure of deferred taxes, if any, reported in the statement of operations? [AAG-INV, par. 5.33]	_____	_____	_____
E. Net Gain or Loss on Investments			
1. Is the sum of realized and unrealized net gain or loss on investments presented in the statement of operations as a net gain or loss on investments?	_____	_____	_____
2. Are the significant effects of futures or options trading activities disclosed separately? [AAG-INV, par. 5.34]	_____	_____	_____
F. Net Increase or Decrease in Net Assets Resulting from Operations			
1. Is the sum of investment income-net and net gain or loss on investment shown as a net increase or decrease in net assets resulting from operations? [AAG-INV, par. 5.35]	_____	_____	_____

Statement of Changes in Net Assets

A. Does the increase or decrease in net assets include the following categories:			
1. Operations			
a. Net investment income or loss?	_____	_____	_____
b. Net realized gains and losses?	_____	_____	_____
c. Changes in unrealized gains or losses on investments?	_____	_____	_____
2. If equalization accounting is followed, is the undistributed investment income included in the price of capital shares issued or reacquired?	_____	_____	_____
3. Distributions to shareholders			
a. Distribution from undistributed investment income?	_____	_____	_____
b. Distribution from undistributed realized gains from investment transaction?	_____	_____	_____
c. Distributions from other sources (e.g., return of capital)?	_____	_____	_____
d. Per-share amounts of distributions? [AAG-INV, par. 5.37]	_____	_____	_____
B. Is disclosure of declared but undistributed per-share amounts disclosed in the notes? [AAG-INV, par. 5.37]	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
C. Are the following components of capital share transactions disclosed on the face of the statement or in the notes as follows:			
1. The number and value of shares sold?	_____	_____	_____
2. The number and value of shares issued in reinvestment of distributions?	_____	_____	_____
3. The number and value of shares reacquired?	_____	_____	_____
4. The net change? [AAG-INV, par. 5.37]	_____	_____	_____
D. If closed-end, has disclosure been made of the weighted average discount per share between the cost of share repurchases and net asset value on such date? [Reg. S-X 6.03]	_____	_____	_____
E. Are net assets disclosed at the beginning and end of the year, including an indication (usually parenthetically) of undistributed investment income (this amount should agree with the comparable amount in the statement of assets and liabilities)? [AAG-INV, par. 5.37]	_____	_____	_____

Supplementary Information

A. Does the information include selected per-share data and ratios for a period of at least five years or from the date of inception? [AAG-INV, par. 5.38]	_____	_____	_____
B. Are per-share amounts presented based on a share outstanding throughout the period? [AAG-INV, par. 5.38]	_____	_____	_____
C. Is the following per-share information presented:			
1. Investment income?	_____	_____	_____
2. Expenses?	_____	_____	_____
3. Expense reimbursement/ waivers?	_____	_____	_____
4. Income taxes and interest on borrowed funds, if material?	_____	_____	_____
5. Per-share investment income-net?	_____	_____	_____
6. Distributions from undistributed investment income, undistributed net realized gain through investment transactions, and from other sources?	_____	_____	_____
7. Realized and unrealized gains and losses per-share that are balancing amounts necessary to reconcile the changes in net asset value per-share with other per-share information presented?	_____	_____	_____
8. The increase or decrease in net asset value per-share?	_____	_____	_____
9. The net asset value at the beginning and end of each period? [AAG-INV, par. 5.39]	_____	_____	_____
D. Are the ratios of investment income-net and expenses to average net assets presented? [AAG-INV, par. 5.40]	_____	_____	_____
E. Are ratios of net investment income and expenses to average net assets for periods of less than one year annualized?	_____	_____	_____
F. Are ratios of net investment income and expenses to average net assets disclosed prior to expense reimbursement/waivers?	_____	_____	_____
G. Is average debt per-share (including bank debt) disclosed?	_____	_____	_____
H. Is disclosure made of the method of calculating the per-share data where the results obtained by following the instructions to Form N-1A are unreasonable? [AAG-INV, par. 5.39]	_____	_____	_____
I. Are appropriate adjustments made for all stock split-ups and stock dividends?	_____	_____	_____
J. Is disclosure made of the date of any change in investment advisor?	_____	_____	_____
K. Is other information necessary for comparability between periods disclosed?	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
L. Is consideration given to including additional ratios, such as turnover rates, number of shares outstanding at the end of each period, and the total return or yield information for money market investment companies, presented? [AAG-INV, par. 5.40]	_____	_____	_____
M. Are the per-share amounts of distributions from undistributed net investment income of municipal bond funds stated separately for amounts applicable to taxable and tax-exempt dividends? [AAG-INV, par. 5.41]	_____	_____	_____

Interim Financial Statements

A. Is quarterly financial information complete and based upon GAAP in a manner that conforms to principles used in preparing annual financial statements? [AAG-INV, par. 5.42]	_____	_____	_____
B. Does the statement of changes in net assets present information on the latest interim period and the preceding fiscal year? [AAG-INV, par. 5.43]	_____	_____	_____
C. Is unaudited interim financial data marked accordingly? [AAG-INV, par. 5.44]	_____	_____	_____
D. Is data summarized in condensed form labeled as unaudited? [AAG-INV, par. 5.44]	_____	_____	_____
E. If the independent accountant does not perform an audit or review, but is identified in the interim report, does he or she insist that the reference be deleted or that a disclaimer of opinion be included? [AAG-INV, par. 5.44]	_____	_____	_____
F. Is the fact that management determines that a tax return of capital is likely to occur for the entity's fiscal year disclosed in the interim financial statements? [SOP 93-2, par. 13e]	_____	_____	_____

SEC Compliance Disclosures Per Regulations S-X

A. Is the total cost for federal income tax purposes of the portfolio disclosed? [Reg. S-X, Rule 12-2, note 8]	_____	_____	_____
B. Are the additional disclosures made as required by:			
1. Reg. S-X, Rule 12-12 (Note 2), pertaining to collateral for repurchase agreements?	_____	_____	_____
2. Reg. S-X, Rule 4-08(m), pertaining to carrying amounts of repurchase or reverse repurchase that exceed 10% of total assets?	_____	_____	_____
3. Disclosure of the average amount of borrowings outstanding during the period, the weighted-average interest rate, and the maximum amount of debt outstanding during the period, according to Rule 6-04.13(b), referring to Rules 5.02.19(b) and 5.02.22(b) of Reg. S-X?	_____	_____	_____
4. The SEC's Codification of Financial Reporting Policies, section 404, and Reg. S-X, Rule 12-12 (6), regarding restricted securities?	_____	_____	_____
5. Reg. S-X, Rule 12-12 (Note 8), pertaining to gross unrealized appreciation for all securities in which there is an excess of value over tax cost and gross unrealized depreciation for all securities in which there is an excess of tax cost over value, as well as net unrealized appreciation or depreciation?	_____	_____	_____
6. Reg. S-X, Rules 210.6—.04.16, 210.6—.04.17, and 210.6—.04.18, pertaining to the elements of net assets as part of the statement of assets and liabilities, rather than in the notes to the financial statements?	_____	_____	_____
7. Reg. S-X, Rule 12-12 (Note 5), pertaining to nonincome producing securities?	_____	_____	_____
8. Reg. S-X, Rule 12.14 (Note 16), pertaining to the increase or decrease in investments in and advances to affiliates?	_____	_____	_____

FSP Section 16,300

Illustrative Financial Statements

.01

Independent Auditor's Report

To the Shareholders and Board of Directors:

XYZ Management Investment Company

We have audited the accompanying statement of assets and liabilities of XYZ Management Investment Company (or Statement of Net Assets), including the schedule of investments in securities, covered call options written, and securities sold short as of December 31, 19X4, the related statement of operations for the year then ended, the statement of changes in net assets for each of the two years in the period then ended, and the selected per share data and ratios for each of the five years in the period then ended. These financial statements and selected per share data and ratios are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and per share data and ratios based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and per share data and ratios are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of December 31, 19X4 by correspondence with the custodian and brokers. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and selected per share data and ratios referred to above present fairly, in all material respects, the financial position of XYZ Management Investment Company as of December 31, 19X4, the results of its operations for the year then ended, the changes in its net assets for each of the two years in the period then ended, and the selected per-share data and ratios for each of the five years in the period then ended, in conformity with generally accepted accounting principles.

[Signature]

[City]

[Date]

XYZ MANAGEMENT INVESTMENT COMPANY

.02

Statement of Assets and Liabilities *

December 31, 19X4

(000's omitted)

Assets

Investments in securities, at value—identified cost \$19,294	\$21,721
Cash	199
Deposits with brokers for securities sold short	1,555
Receivables	
Dividends and interest	46
Investment securities sold	24
Capital stock sold	54
Other assets	26
Total assets	<u>23,625</u>

Liabilities

Covered call options written, at value—premiums received \$110	230
Securities sold short at value—proceeds \$1,555	1,673
Demand loan payable to bank (Note 5)	2,000
Payable upon return of securities loaned (Note 9)	620
Payables	
Investment securities purchased	52
Capital stock reacquired	8
Other	4
Accrued taxes	8
Distribution payable	168
Total liabilities	<u>4,763</u>

Net Assets

Net assets (equivalent to \$4.47 per share based on 4,216 shares of capital stock outstanding) (Note 6)	<u>\$18,862</u>
--	-----------------

The accompanying notes are an integral part of these financial statements.

* A statement of assets and liabilities is an alternative presentation to a statement of net assets. The reader should be aware, however, that SEC rules do not always consider the two statement formats to be alternative presentations. [AAG-INV, par. 5.47]

XYZ MANAGEMENT INVESTMENT COMPANY

.03

Schedule of Investments in Securities

December 31, 19X4

(000's omitted)

Note: Securities may be arranged by industry groupings or other groupings (showing percentage of total portfolio or of net assets invested in each grouping) that the company believes are most meaningful to users. The basis of the computation of percentages shown, which in this illustration is based on the ratio of the specific category of securities to the total portfolio owned, should be disclosed.]

	<i>Principal Amount or Shares</i>	<i>Value</i>
Common Stocks—54%		
Consumers' durable goods—5%		
Allied Manufacturing Corporation	25	\$ 620
Baker Industries, Inc.	15	150
Etc. (other common stocks)		316
Consumers' nondurable goods—2%		
Amalgamated Buggy Whips, Inc. (Note 2)	10	280
Etc. (Other common stocks)		155
Service industries—4%		
Service Company, Inc.	10	465
Etc. (Other common stocks)		404
Etc. (other industry groupings)—43%		9,351
Total common stocks (cost \$10,294)		<u>11,741</u>
Convertible bonds—25%		
American Retailing Inc.—5.5% debentures due 19XX	\$500	525
Etc. (other convertible bonds)		4,875
Total convertible securities (cost \$4,400)		<u>5,400</u>
U.S. government obligations—16%		
U.S. Treasury 6% notes due 20XX	\$500	490
Etc. (other long-term government obligations)		2,985
Total U.S. government obligations (cost \$3,500)		<u>3,475</u>
Short-term notes—3%		
Commercial Paper, Inc. due 2/5/X5	\$500	505
U.S. Treasury bills, due 1/20/X5	\$100	100
Total short-term notes (cost \$600)		<u>605</u>
Repurchase agreements collateralized by U.S. government obligations—2%		
Money Center Bank of Large City, 11% due 1/3/X5 (cost \$500)	\$500	500
Total 100% (cost \$19,294)		<u>\$21,721</u>

The accompanying notes are an integral part of these financial statements.

XYZ MANAGEMENT INVESTMENT COMPANY

.04

Statement of Operations

Year Ended December 31, 19X4

(000's omitted)

Investment income

Income		
Dividends	\$742	
Interest	259	
Total income		\$ 1,001

Expenses

Investment advisory fee (Note 8)	90	
Interest	55	
Professional fees (Note 8)	29	
Custodian and transfer agent fees	12	
Distribution expenses (Note 8)	4	
State and local taxes other than income taxes	15	
Directors' fees	12	
Dividends on securities sold short	9	
Total expenses		226
Investment income—net		775

Realized and unrealized gain (loss) on investments (Note 7)

Net realized gain on investments	1,089	
Change in unrealized appreciation of investments for the year	(1,649)	
Net loss on investments	(560)	
Net increase in net assets resulting from operations		\$ 215

The accompanying notes are an integral part of these financial statements.

XYZ MANAGEMENT INVESTMENT COMPANYYY

.05

Statement of Net Assets *

December 31, 19X4

(000's omitted)

	<u>Shares or Principal Amount</u>	<u>Value</u>
Assets		
Investments in securities—115% of net assets		
Note: Securities may be arranged by industry or other groupings (showing the percentage of total portfolio or of net assets invested in each grouping) that the company believes will be most meaningful to the user.		
Common stocks—62%		
Consumers' durable goods—6%		
Allied Manufacturing Corporation	25	\$ 620
Baker Industries, Inc.	15	150
Etc. (other common stocks)		316
Consumers' nondurable goods—2%		
Amalgamated Buggy Whips, Inc. (Note 2)	10	280
Etc. (other common stocks)		155
Service industries—5%		
Service Company Inc.	10	465
Etc. (other common stocks)		404
Etc. (other industry groupings)—49%		9,351
Total common stocks (cost \$10,294)		<u>11,741</u>
Convertible bonds—29%		
American Retailing Inc.—5.5% debentures due 19XX	\$500	525
Etc. (other convertible bonds)		4,875
Total convertible bonds (cost \$4,400)		<u>5,400</u>
U.S. government obligations—18%		
U.S. Treasury—6% notes due 20XX	\$500	490
Etc. (other long-term obligations)		2,985
Total U.S. government obligations (cost \$3,500)		<u>3,475</u>
Short-term notes—3%		
Commercial Paper, Inc. due 2/5/X5	\$500	505
U.S. Treasury bills, 1/20/X5	\$100	100
Total short-term notes (cost \$600)		<u>605</u>
Repurchase agreement collateralized by U.S. government obligations—3%		
Money Center Bank of Large City—11% due 1/3/X5 (cost \$500)	\$500	500
Total investments in securities (cost \$19,294)		<u>21,721</u>
Other assets—10%		1,904
Total assets		<u>23,625</u>

(continued)

* A statement of assets and liabilities is an alternative presentation to a statement of net assets. The reader should be aware, however, that SEC rules do not always consider the two statement formats to be alternative presentations. [AAG-INV, par. 5.47]

XYZ MANAGEMENT INVESTMENT COMPANY

.05

Statement of Net Assets *—continued

December 31, 19X4

(000's omitted)

	<u>Shares or Principal Amount</u>	<u>Value</u>
Liabilities		
Demand loans payable to bank—10% (Note 5)		2,000
Securities sold short—9%		1,673
Other liabilities—6%		1,090
Total liabilities		<u>4,763</u>
Net assets		
Net assets (equivalent to \$4.47 per share based on 4,216 shares of capital stock outstanding) (Note 6)		<u>\$18,862</u>
The accompanying notes are an integral part of these financial statements.		

* A statement of assets and liabilities is an alternative presentation to a statement of net assets. The reader should be aware, however, that SEC rules do not always consider the two statement formats to be alternative presentations. [AAG-INV, par. 5.47]

XYZ MANAGEMENT INVESTMENT COMPANY

.06

Statement of Changes in Net Assets

Years Ended December 31, 19X4, and 19X3

(000's omitted)

	<u>19X4</u>	<u>19X3</u>
Increase (decrease) in net assets from operations		
Investment income—net	\$ 755	\$ 492
Net realized gain on investments	1,089	1,000
Change in unrealized appreciation	(1,649)	1,551
Net increase in net assets resulting from operations	215	3,043
Net equalization credits	9	6
Distributions to shareholders from—		
Investment income—net (\$.16 and \$.16 per-share, respectively)	(525)	(350)
Net realized gain on investments (\$.34 and \$.33 per-share, respectively)	(1,350)	(1,066)
Capital share transactions (Note 6)	2,721	1,749
Total increase	1,070	3,382
Net assets		
Beginning of year	17,792	14,410
End of year (including undistributed investment income of \$639,000 and \$380,000, respectively)	<u>\$ 18,862</u>	<u>\$ 17,792</u>

The accompanying notes are an integral part of these financial statements.

XYZ MANAGEMENT INVESTMENT COMPANY

.07

Covered Call Options Written

December 31, 19X4

(000's omitted)

<u>Common Stocks/Expiration Date/Exercise Price</u>	<u>Shares Subject to Call</u>	<u>Value</u>
Allied Manufacturing Corporation/July/25	10	\$ 50
Allied Manufacturing Corporation/October/30	5	3
Etc. (other options written)		177
Total (premiums received \$110) (Note 3)		<u>\$230</u>

The accompanying notes are an integral part of these financial statements.

XYZ MANAGEMENT INVESTMENT COMPANY

.08

Securities Sold Short

December 31, 19X4

(000's omitted)

<u>Common Stock</u>	<u>Shares</u>	<u>Value</u>
International Widgets, Inc.	40	\$ 425
Paper Airplane Corporation	25	265
Etc. (other common stocks)		983
Total (proceeds \$1,555)		<u>\$1,673</u>

The accompanying notes are an integral part of these financial statements.

XYZ MANAGEMENT INVESTMENT COMPANY

.09

Notes to Financial Statements

The following notes to the financial statements are illustrative only. In some circumstances, the information may be better presented within the financial statements; in other circumstances, information not required by regulation may not be sufficiently material to be disclosed.

Note 1: Significant Accounting Policies

The Company is registered under the Investment Company Act of 1940 as a diversified, open-end management investment company.

Security valuation. Investments in securities traded on a national securities exchange (or reported on the NASDAQ national market) are stated at the last reported sales price on the day of valuation. Other securities traded in the over-the-counter market and listed securities for which no sale was reported on that date are stated at the last quoted bid price, except for short positions and call options written for which the last quoted asked price is used. Short-term notes are stated at amortized cost, which is equivalent to value. Restricted securities and other securities for which quotations are not readily available are valued at fair value as determined by the board of directors.

Federal income taxes. The Company's policy is to comply with the requirements of the Internal Revenue Code that are applicable to regulated investment companies and to distribute all its taxable income to its shareholders. Therefore, no federal income tax provision is required.

Equalization. The Company uses the accounting practice of equalization, by which a portion of the proceeds from sales and costs of redemption of capital shares, equivalent on a per-share basis to the amount of undistributed net investment income on the date of the transactions, is credited or charged to undistributed income. As a result, undistributed net investment income per share is unaffected by sales or redemptions of capital shares.

Distributions to shareholders. Dividends to shareholders are recorded on the ex-dividend date.

Other. The Company follows industry practice and records security transactions on the trade date. Dividend income is recognized on the ex-dividend date and interest income is recognized on an accrual basis. Discounts and premiums on securities purchased are amortized over the life of the respective securities.

Note 2: Restricted Securities

The investment in 10,000 shares of Amalgamated Buggy Whips, Inc. common stock, the sale of which is restricted, has been valued by the board of directors after considering certain pertinent factors, including the results of operations of Amalgamated since the date of purchase in 19X1 and the sales price of recent private placements in its common stock. There is no quoted market for Amalgamated shares.*

Note 3: Covered Call Options Written

As of December 31, 19X4, portfolio securities valued at \$1,908,000 were held in escrow by the custodian in connection with covered call options written by the Company.

Note 4: Distribution of Shareholders

On January 3, 19X5, a distribution of \$0.20 aggregating \$840,000 was declared from net realized gains from investment transactions (including \$0.02 applicable to short-term gains that are taxable to shareholders as

* If several restricted security investments are held, a general statement on the valuation methods may be given rather than individual descriptions.

ordinary income dividends) during 19X4. The dividend was paid on January 20, 19X5, to shareholders of record on January 10, 19X5.

As of December 31, 19X4, the Company had available for federal income tax purposes an unused capital loss carryover of approximately \$1,500,000 that will expire in 19X5.*

Note 5: Bank Loans

The Company has an unsecured \$3,000,000 bank line of credit. Borrowings under this arrangement bear interest at 110 percent of the bank's prime rate. As of December 31, 19X4, the Company was paying interest at 11 percent per year on its outstanding borrowings. No compensating balances are required.

Note 6: Capital Share Transactions

As of December 31, 19X4, there were 25,000,000 shares of \$0.50 par value capital stock authorized and capital paid-in aggregated \$15,184,000.

Transactions in capital stock were as follows:

	<i>Shares</i>		<i>Amount</i>	
	<i>19X4</i>	<i>19X3</i>	<i>19X4</i>	<i>19X3</i>
Shares sold	452,000	329,000	\$2,177,000	\$1,434,000
Shares issued in reinvestment of dividends	222,000	207,000	1,000,000	845,000
	674,000	536,000	3,177,000	2,279,000
Shares redeemed	104,000	121,000	456,000	530,000
Net income	570,000	415,000	\$2,721,000	\$1,749,000

Note 7: Investment Transactions

Purchases and sales of investment securities (excluding short-term securities) were \$32,000,000 and \$23,300,000, respectively; for common stocks and bonds, purchases and sales of U.S. government obligations were \$3,300,000 and \$2,000,000. Net loss on investments for the year ended December 31, 19X4, was \$560,000. That amount represents the net decrease in value of investments held during the year.

The components are as follows:

Long transactions	\$(501,000)
Short sale transactions	(75,000)
Covered call options written	16,000
	<u>\$(560,000)</u>

As of December 31, 19X4, the unrealized appreciation of securities was \$2,189,000; accumulated undistributed net realized gains on investment transactions totaled \$850,000.

Note 8: Investment Advisory Fees and Other Transactions with Affiliates

The Company pays advisory fees for investment management and advisory services under a management agreement ("Agreement") that provides for fees to be computed at an annual rate of 0.5 percent of the Company's average daily net assets. Certain officers and directors of the Company are also officers and directors of the investment adviser. The Agreement provides for an expense reimbursement from the investment adviser if the Company's total expenses, exclusive of taxes, interest on borrowings, dividends on securities sold short, brokerage commissions, and extraordinary expenses, exceed 1.5 percent of the Company's average daily net assets for any full fiscal year. An expense reimbursement was not required for either 19X4 or 19X3. An expense reimbursement of \$0.01 per share was required in 19X0.

* This would be disclosed if the Company has an available capital loss carryover as of December 31, 19X4.

The investment adviser also received \$10,000 in 19X4 and \$15,000 in 19X3 from commissions earned on sales of XYZ Management Investment Company capital stock and \$5,000 in 19X4 and \$8,000 in 19X3 from brokerage fees on its executions of purchases and sales of portfolio investments.

During 19X4, the Company incurred legal fees of \$7,000 to Brown and Smith, counsel for the Company. John F. Smith, a partner of the firm, is a director of the Company. MNO Service Company, an affiliate of the investment adviser, received \$4,000 in expense reimbursements for shareholder-related distribution expenses undertaken pursuant to a shareholder-approved plan.

Note 9: Portfolio Securities Loaned

As of December 31, 19X4, the Company loaned common stocks having a value of approximately \$570,000 and received cash collateral of \$620,000 for the loan.

Supplementary Information—Selected Per-Share Data and Ratios*

	<u>19X4</u>	<u>19X3</u>	<u>19X2</u>	<u>19X1</u>	<u>19X0</u>
Per-Share Data					
Investment income	\$.27	\$.30	\$.24	\$.20	\$.18
Expenses	<u>.06</u>	<u>.10</u>	<u>.05</u>	<u>.03</u>	<u>.03</u> **
Investment income—net	.21	.20	.19	.17	.15
Distributions from investment income net	(.16)	(.16)	(.17)	(.17)	(.15)
Net realized and unrealized gain (loss) on securities	(.12)	.71	.52	(.42)	.48
Distributions from realized gains on securities	<u>(.34)</u>	<u>(.33)</u>	<u>(.24)</u>	<u>(.23)</u>	<u>(.20)</u>
Net increase/decrease in net asset value	(.41)	.42	.30	(.65)	.28
Net asset value:					
Beginning of year	<u>4.88</u>	<u>4.46</u>	<u>4.16</u>	<u>4.81</u>	<u>4.53</u>
End of year	<u>\$4.47</u>	<u>\$4.88</u>	<u>\$4.46</u>	<u>\$4.16</u>	<u>\$4.81</u>
Ratios					
Ratio of expenses to average net assets (%)	1.33	1.31	.99	.82	.84
Ratio of investment income—net to average net assets (%)	4.56	2.82	4.22	5.42	5.10

* Selected data for a share of capital stock outstanding throughout the year.

** See Note 8 of the notes to financial statements.

Note: Form N1-A requires disclosure of the portfolio turnover rate and number of shares at the end of each period in the condensed financial information. [AAG-INV, par. 40]

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